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***October 24, 2000***

***To the Citizens of the Commonwealth of Massachusetts,  
Governor Argeo Paul Cellucci, and Honorable Members of the  
General Court***

I am pleased to report that as of June 30, 2000, the financial condition of the Commonwealth remains sound. Over \$1.6 billion, or approximately 7.1% of budgeted revenues, is in the Commonwealth's Stabilization Fund, sometimes called the "rainy day" fund. With the fund nearly at the maximum, the Commonwealth is preparing for that inevitable rainy day.

The fund balance in the budgeted funds at the end of the year reflects a prudent fiscal strategy. Year-end transfers of budget surpluses were made to the capital projects funds to make strategic investments for the management of the Commonwealth's capital budget, to defease high interest debt that otherwise could not be refunded and continue to increase reserves for an inevitable economic down turn. In connection with the supplemental funding of the Central Artery / Tunnel Project and Statewide Road and Bridge Program, \$650 million in operating surpluses from fiscal 2000 and prior years were set aside to defease high interest debt. This is in addition to \$400 million set aside during fiscal year 1999. The purpose of these transfers was to use the debt service savings for the project and for the statewide road and bridge program. An additional \$205.6 million was transferred to capital projects to finance projects that would normally be funded with general obligation debt. After these transfers, nearly \$2.3 billion, 14.6% of annual tax revenues, remained in the Commonwealth's budgeted funds, including the \$1.6 billion in the Stabilization Fund.

Probably the most significant change in the Commonwealth's financial management is the change in the financial relationship with the Massachusetts Bay Transportation Authority, (MBTA). For decades, the Commonwealth has been the payer of last resort for the MBTA. The Commonwealth recognized this liability 18 months in arrears. For years the difference between what the MBTA spent and took in as revenues was presented to the Treasurer as the request for a cash advance, which was paid and then budgeted by the Legislature in subsequent fiscal years. While the old law provided a number of procedures to control the growth in spending, this structure excluded the MBTA from the normal budgetary review process. In addition, because transit fares had remained level and contributions from cities and towns have a growth ceiling under proposition 2½, the bill to the Commonwealth included a disproportionate share of the increase in expense. Beginning in fiscal year 2001 (FY01) a new funding mechanism is in place. The Commonwealth will set aside 20% of sales tax revenues, along with amounts assessed on the cities and towns within the service district in a separate fund. The MBTA will control its

## ***MBTA Forward Funding***

### Sources of Funds

G.O. Bonds Issued.....	\$325,000,000
Operating Transfers.....	10,540,000
Amount to be Amortized.....	<u>612,750,000</u>
Total Sources of Funds to the MBTA...	<u>948,290,000</u>

### Uses of Funds

#### Net Cost of Service Paid For:

Calendar Year 1999 and Before.....	505,750,000
1/1-6/30/00 Including Operating	
Interest.....	342,540,000
Working Capital.....	<u>100,000,000</u>
Total Cost of Forward Funding.....	<u>\$948,290,000</u>

own destiny by balancing its spending needs with available revenue sources, including this dedicated revenue stream from the Commonwealth. In addition, while the Commonwealth will continue to guarantee existing debt of the MBTA, it will not guarantee future debt issuance.

One crucial step in this process was for the Commonwealth to recognize the 18 month lag in operating subsidies previously financed through the loaning of cash reserves to the MBTA and the issuance of notes by the Commonwealth and the MBTA. Under this convoluted process, conceived in the 1960's, the calendar 1998 operating deficit of the MBTA was appropriated in the FY00 budget. In order to catch up, the Commonwealth needed to budget this lag (January 1999 – June 30, 2000) in FY00. The cost of this lag is \$848 million. This cost, along with \$100 million in working capital, was financed by \$325 million in General Obligation bonds, \$10.5 million in operating appropriations and a \$612.8 million in authorization in the capital projects fund. Additional bonds have been authorized to finance this final piece, but only if it is determined that it cannot be supported within the Commonwealth's cash flow. Otherwise it will be amortized over 20 years in the operating budget.

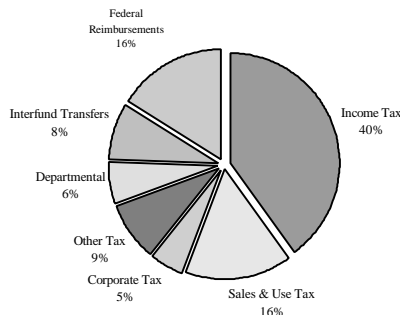
In accordance with Massachusetts General Laws, the Office of the Comptroller transmits the Statutory Basis Financial Report, (SBFR,) on or before October 31<sup>st</sup>. The SBFR report for fiscal year ended June 30, 2000 (FY00,) herein is audited by Deloitte & Touche, Independent Certified Public Accountants and represents the conclusion of financial activity and the closing of the Commonwealth's books on the statutory basis of accounting for the fiscal year. This audit is conducted in conjunction with the Office of the State Auditor, which provides knowledge, expertise and resources to close and audit the year.

This report includes the budgeted funds, non-budgeted special revenue funds, capital project funds, fiduciary funds and the non-appropriated funds of higher education.

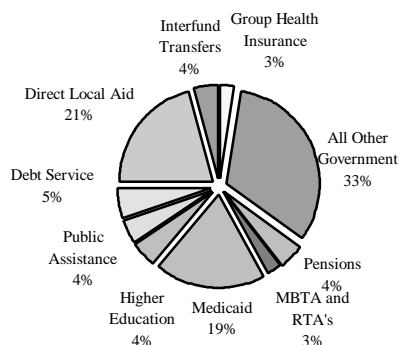
The financial operations of these funds are maintained in the Massachusetts Management Accounting and Reporting System, (MMARS). The statewide accounting system is operated by the Commonwealth and contains detailed information summarized in this report.

The SBFR is intended to satisfy the requirements of state finance law, and to present fairly the results of FY00 activity in the Commonwealth's funds. The report contains computations required by state finance law, including the certification of the Stabilization Fund and Tax Reduction Fund. The statutory basis of accounting, defined in Massachusetts's law, is typically used to budget and control fiscal operations. The statutory basis of accounting is not in accordance with generally accepted accounting principles, (GAAP,) as defined for governments by the Government Accounting Standards Board. I will report the Commonwealth's financial position on a GAAP basis in December, in our Comprehensive Annual Financial Report, (CAFR).

### ***Budgeted Revenues and Other Sources***



### ***Budgeted Expenditures and Other Uses***



### ***Budgeted Funds***

For fiscal 2000, sources of budgeted funds exceeded uses of budgeted funds, resulting in an “operating gain” of \$173 million. The gain is net of the \$500 million in transfers done at year-end to defease high interest debt as part of the Central Artery / Tunnel Project – Statewide Road and Bridge financing plan and \$205.6 million transferred to fund future capital projects.

More importantly, any gain or loss has to be viewed in a trend. Generally accepted standards indicate that a structural balance is achieved when revenues exceed expenditures over a period of multiple years. Before one time uses of surplus, the Commonwealth has a decade-long record of operating gains. The \$205.6 million transferred for capital outlay allows the Commonwealth to sell less in bonds in the future to pay for capital costs. The funds for defeasance allow the Commonwealth to pay less in the future for capital costs already bonded. When viewed in an overall fiscal context, this is sound policy.

In FY00, budgeted revenues and other sources grew 12.0% over FY99 reflecting a strong economy in the Commonwealth, even though a number of tax cuts were implemented that affected both earned and unearned income. Even more indicative of the strong economy is that budgeted tax revenue increased by 9.8% over FY99. From a multi-year perspective, the proportion of revenue sources by category to total budgeted revenues and other sources did not materially change from FY99 to FY00. Personal income, sales and corporate taxes continue to be the three largest sources of tax revenue for the Commonwealth.

Budgeted expenditures and other uses, including transfers, increased 10.7% from FY99 to FY00. The Budgeted Funds – Operations table on page 4 displays the FY00 summary of budgeted funds, compared to FY99. Financial statements for each of the 63 individual budgeted funds are included in the financial section of this report.

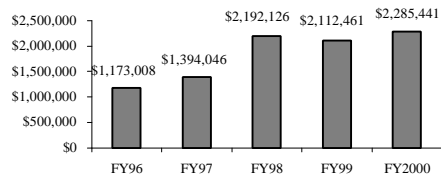
In conducting the budget process, the Commonwealth excludes those “interfund” transactions within the budgeted funds that, by their nature, have no impact on the combined fund balance of the budgeted funds. The table isolates this “interfund” activity from the budgeted sources and uses to align forecasts prepared during the budget process to actual amounts in this report. For example, the Budgeted Funds – Operations table on the following page, isolates the assessments on municipalities collected by the Commonwealth and paid to the MBTA and regional transit authorities. The dramatic increase in “total revenues” and “total expenditures” is the effect of \$3 billion in transfers among the three major operating funds of the Commonwealth. Those interested in trend analysis should consider the comparison of “budgeted revenues and other sources” to “budgeted expenditures and other uses” rather than the respective total lines. A detailed list of these interfund transfers is included in note #3.

**Budgeted Funds - Operations**  
(Amounts in thousands)

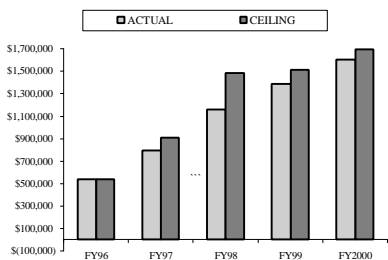
	1999	2000
Beginning fund balances:		
Reserved and designated.....	\$ 286,348	\$ 330,227
Reserved for Tax Reduction .....	367,663	6,818
Reserved for Stabilization Fund.....	1,159,588	1,388,523
Undesignated.....	378,527	386,893
Total.....	2,192,126	2,112,461
Revenues and other sources:		
Taxes.....	14,291,463	15,688,616
Federal reimbursements.....	3,442,929	3,645,550
Departmental and other revenues.....	1,297,849	1,359,918
Interfund transfers from non-budgeted funds and other sources.....	1,132,863	1,893,004
Budgeted revenues and other sources.....	20,165,104	22,587,088
Mass transit assessments.....	159,916	15,821
Intragovernmental Service Fund revenues.....	96,860	99,663
Interfund transfers among budgeted funds and other sources.....	1,145,111	3,518,530
Total revenues and other sources.....	21,566,991	26,221,102
Expenditures and other uses:		
Programs and services.....	17,341,111	19,330,674
Debt service.....	1,173,815	1,193,329
Pension.....	990,211	986,303
Interfund transfers to non-budgeted funds and other uses.....	739,632	903,802
Budgeted expenditures and other uses.....	20,244,769	22,414,108
Payments of mass transit assessments.....	159,916	15,821
Intragovernmental Service Fund expenditures.....	96,860	99,663
Interfund transfers among budgeted funds and other uses.....	1,145,111	3,518,530
Total expenditures and other uses.....	21,646,656	26,048,122
Excess (deficiency) of revenues and other sources over expenditures and other uses.....	(79,665)	172,980
Ending fund balances:		
Reserved and designated.....	330,227	278,526
Reserved for Tax Reduction .....	6,818	7,203
Reserved for Stabilization Fund.....	1,388,523	1,608,382
Undesignated.....	386,893	391,330
Total.....	\$ 2,112,461	\$ 2,285,441

The graph of Budgeted Funds – Fund Balance, on the next page, shows the combined fund balance in the budgeted funds for the past five years. This “bottom line” perspective demonstrates the accumulation of resources attributable to balanced budgets over this period. The FY00 ending balance of \$2.3 billion is composed of three items. The aforementioned Stabilization Fund balance of \$1.6 billion is the largest component. The other components include \$391.3 million undesignated

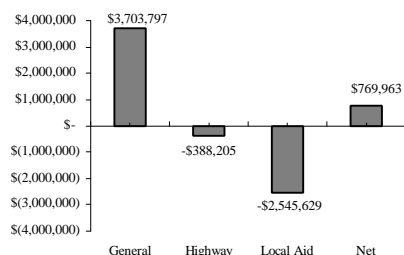
***Budgeted Funds – Fund Balance  
(Amounts in Thousands)***



***Stabilization Fund  
Fund Balance  
(Amounts in Thousands)***



***“Consolidated Net Surplus”  
Prior to Transfers  
(Amounts in Thousands)***



surplus available for appropriation in FY01 and \$278.5 million reserved and designated for continuing appropriations and debt service. I cannot emphasize enough the importance of the balance in the Stabilization Fund and its direct correlation to the positive financial condition in the Commonwealth. State finance law, as amended during FY98, increased the maximum balance that may accumulate in the fund to a level of 7.5% of budgeted revenues and other sources. The law then directs that any amount in excess of this “cap” be transferred to the Tax Reduction Fund for future, one-time, personal income tax rebates. This “cap” for FY00 was \$1.7 billion.

The graph, Stabilization Fund Balance portrays this “cap” and the balance of the fund over a five-year period. Despite the Commonwealth’s positive financial condition, a few cautionary notes are merited. There are certain problems with the definitions in the state finance law, enacted in 1986 and continued with slight modifications to the present. A balanced budget, defined as the “Consolidated Net Surplus,” is the combined undesignated fund balance of the General, Local Aid, and Highway Funds. According to this restricted definition, fiscal balance was achieved in FY00 in the amount of \$769.9 million. However this definition excludes certain components of fund balance, such as reserves for continuing appropriations and the entire balances of other budgeted funds. This definition is idiosyncratic, having the potential to be misleading and confusing. The Commonwealth should adopt a more straightforward definition of fiscal balance. In Chapter 236, Section 79 of the Acts of 2000, the Commonwealth made a positive first step, allowing the Comptroller to eliminate any deficits within the Local Aid and Highway Funds with surpluses from the General Fund.

Under current general laws an amount equal to 0.5% of tax revenues is retained in the funds contributing to the calculation. Any amount in excess of this is available for transfer from the General and Local Aid funds to the Capital Projects Fund in lieu of bonds and the balance is transferred to the Stabilization Fund. In FY00, a special statute directed that up to \$500 million of surplus be set aside to defease debt. After this set aside, \$191.5 million was available for distribution under the formula. Of this amount, \$76.5 million was transferred for capital projects with the remaining balance transferred to the Stabilization Fund.

While this is a sound set aside of surpluses in these three funds, it is important to note that 60 other budgeted funds with combined undesignated fund balances of over \$300 million were not included in the calculation of the transfer. State finance law should be amended to rationalize the contributions to the Stabilization Fund to include the entire population of budgeted funds.

Further complicating this issue is the existence of a large number of “minor” budgeted funds. Over the past several years, dozens of new “minor” funds have been created. These funds split off revenues and expenditures previously accounted for as part of a major fund, such as the General Fund. A number of these funds have structural imbalances leading to chronic deficits. The trend to fragment the budget into such special interest funds should be addressed with a plan to either

consolidate to a more reasonable number of funds or eliminate funds that are structurally in deficit.

A final cautionary note pertains to the disposition of the accumulated surplus. Maintaining a prudent portion of the surplus in the strategic reserve, the Stabilization Fund, is paramount. It is evident, that after a record period of economic growth nationwide, it is inevitable that a slowdown will occur. The Commonwealth must be prepared for this in the face of increasing demands on government. The Legislature and the Governor now face the challenge to frame fiscal policy for the remainder of this surplus. There are numerous choices, each of which has long-term implications on how the Commonwealth maintains its positive financial position. Whatever choices are made, it is important to maintain the long-term structural balance. Accumulated balances should not be committed to purposes with ongoing spending requirements.

### ***Non-Budgeted Funds***

The Non-Budgeted Funds represent operations in which the government has imposed its sovereign authority, but has excluded these operations from the annual budget process. During FY00, the Commonwealth maintained 29 of these funds. The largest funds include the Lottery, Federal Grants, Debt Defeasance, Health Care Security Trust (the recipient of tobacco settlement funds), Grant Anticipation, Sewer Rate Relief, the Medical Security Trust and the Uncompensated Care Funds. These funds are commonly referred to as special or dedicated revenue funds whose revenues are matched to related expenditures.

The table, Non-Budgeted Funds – Operations, includes a summary of the FY00 non-budgeted funds. Financial statements for each of the individual funds are included in the financial section of this report. Several of these funds are worth mentioning. At June 30, 2000, the Federal Grants Fund had a positive fund balance, but there is a deficiency in cash within the fund. This situation results in the Commonwealth drawing funds from the federal government a few days after applicable cash disbursements to assure an “interest neutral” timing of the federal – state cash exchange. These requirements were established by the Cash Management Improvement Act of 1990. Within the Lottery Funds, gross revenues continued to increase this fiscal year. Net income also increased, resulting in an increase of distributions to cities and towns of \$28.2 million. The fund balance remaining in the Lottery Funds reflects an additional \$1.0 million available for distribution to cities and towns in FY01.

**Non-Budgeted Funds - Operations**  
(Amounts in thousands)

	1999	2000
Beginning fund balance.....	\$ 517,609	\$ 903,017
Revenues and other sources:		
Taxes.....	12,734	13,553
Assessments.....	269,555	378,364
Federal grants and reimbursements.....	2,017,000	2,076,386
Departmental and miscellaneous.....	4,107,227	4,681,514
Transfers and other sources.....	999,116	1,008,248
Total revenues and sources.....	7,405,632	8,158,065
Expenditures and other uses:		
Programs and services.....	4,837,590	5,694,496
Debt service.....	38,428	43,686
Transfers and other uses.....	2,154,206	2,233,470
Total expenditures and uses.....	7,020,224	7,971,652
Excess of revenues and sources over expenditures and uses.....	385,408	186,413
Ending fund balance.....	\$ 903,017	\$ 1,089,430

The newest non-budgeted fund, the Health Care Security Trust Fund, receives all revenues from the Master Settlement Agreement (MSA) between the states and the tobacco industry to recover health care costs for tobacco related illnesses. The MSA estimates the Commonwealth revenues for the first 25 years of the settlement at \$7.6 billion. This estimate is prior to potentially major future adjustments for inflation and changes in the volume of domestic cigarette sales. In FY00, the Commonwealth received \$326 million or 92% of the estimated amounts shown in the settlement agreement. Of the \$326 million, \$83.6 million was transferred to the Tobacco Settlement Fund, a budgeted fund, with nearly half of that amount expended on various health initiatives in the Commonwealth. The Trust fund also received nearly \$4.7 million in investment earnings during the year.

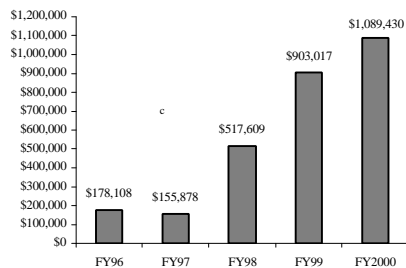
Beginning in FY01, a board of private sector investment experts, appointed by the Governor, the Attorney General and the Treasurer-Receiver-General, will manage the investment of funds in the trust. This board has broad discretion on investment choices to increase the assets in the fund. Annually 30% of payments into the fund and investment earnings thereon will be transferred from the trust to the budgeted funds for appropriation by the Legislature.

Federal Grant Anticipation Notes, (GANS) activity related to the Central Artery / Tunnel project continued this year. During FY98, the Legislature authorized the issuance of up to \$1.5 billion in GANS to finance the current cash needs of the Project. As of June 30, 2000, \$900 million of the GANS have been issued. These GANS mature between 7 to 17 years from the date of issuance and are redeemed by pledged future federal reimbursements. The GANS are not considered general obligation debt of the Commonwealth. Activity related to issuance of

GANS and the accumulation of pledged funds and the payment of debt service is accounted for in the Grant Anticipation Note Trust Fund. The \$158.5 million deficit balance in the fund represents \$50.0 million held for payment of interest on the GANS offset by a \$208.5 million cash deficiency due to expenditures incurred before the issuance of additional GANS. The final \$600 million portion of the GANS are due to be issued in FY01. Part of the proceeds will be used to immediately “cure” any cash deficiency in the fund.

The universal health care funds established in 1988, including the Uncompensated Care, Labor Shortage and Medical Security Trust Funds, have increased their annual revenue to over \$1.1 billion. They also have a combined fund balance of nearly \$266.5 million.

***Non-Budgeted Funds –  
Fund Balance  
(Amounts in Thousands)***



The graph Non-Budgeted Funds Balance shows the combined fund balance in the Non-Budgeted funds for the past five years. In each year, the entire balance is designated for the specific purpose of the fund. The overall growth in fund balance in these funds this fiscal year is due largely to deposits into the Debt Defeasance and Health Care Security Trust Funds. The GANS fund had a net deficit for the year due to timing. As indicated in previous years, more consolidation and elimination is needed for these funds. For example, the Government Land Bank Fund has a chronic structural fund deficit. The FY00 deficit balance of \$35.0 million represents an unbudgeted drain on the General Fund’s overall cash flow. While steps have been taken to stop the growth in this deficit, the fund should be abolished and the deficit transferred into the General Fund. A periodic reexamination of all non-budgeted funds represents sound financial practice.

***Capital Projects Funds***

The purpose of these funds is to construct or acquire capital assets for governmental use. The Governor may propose capital outlay budgets, which, upon enactment by a two-thirds vote of the Legislature and approval by the Governor, become capital outlay acts. Numerous acts may be combined for reporting in an individual Capital Projects Fund, but each act is accounted for separately within the Capital Project Fund. These accounts record authorizations for expenditures in itemized capital appropriation accounts and equivalent authorizations to issue bonds or notes in anticipation of federal reimbursements.

The structure of these funds is that each capital outlay authorization is in balance, creating authorization for inflows, which may be from sales of bonds, federal reimbursements or other revenues and authorization for expenditures. Imbalances due to timing differences develop when the expenditure precedes the inflow of funds from the sale of bonds or federal reimbursements. Because of federal tax arbitrage rules, it is more difficult to sell bonds in anticipation of expenditures. The sale of bonds in advance is not commonplace in the Commonwealth. However, two sales this year provided funds that were received in anticipation of expenditures. These funds were primarily used to pay off the aforementioned notes of the MBTA. Bonding in arrears contributes to the timing imbalance. As a result, these funds report not only temporary fund deficits, but cash deficits as well.



**Central Artery / Tunnel Project**  
**(Amounts in Billions)**

**Sources of Funds:**

Federal Funds	\$ 7.049
MTA	1.793
MassPort	0.365
GANS	1.500
Other Commonwealth Debt	2.815
Commonwealth Operating Funds and Investment Earnings	0.553

**Total Sources** \$ 14.075

**Costs of Construction:**

Actual Costs through FY00	\$ 9.122
Estimated Spending:	
FY01	1.744
FY02	1.371
FY03	0.940
FY04	0.658
FY05	0.240

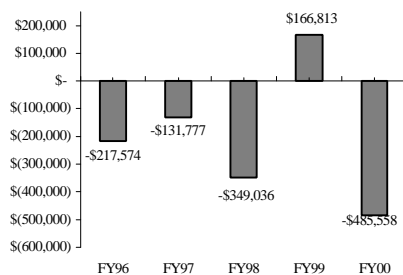
**Total Estimated Costs of Construction:** \$ 14.075

A significant portion of the Capital Projects activity relates to the Central Artery / Tunnel Project. The Central Artery / Tunnel Project has been the target of an enormous amount of public scrutiny. As indicated in our footnotes, the financial disclosure portion of the Project is under review with various federal agencies. The Commonwealth has aggressively responded to these concerns regarding the integrity of the cost estimates. Under the leadership of former Secretary for Administration and Finance Andrew Natsios and the current Secretary Stephen Crosby, an independent evaluation of the entire estimate for the project was undertaken. The results were fully disclosed and a finance plan for the cost increases was enacted. The Commonwealth has also put in place a new management team for the Project that is committed to full, timely disclosure about schedules and costs. The bulk of the spending remaining on the Project is currently estimated to occur during FY01 and FY02, with final completion now targeted in FY05.

Pursuant to statute and agreements with the Massachusetts Turnpike Authority, (the MTA) and the Massachusetts Port Authority (MassPort), the entities have committed to significant ongoing contributions to the Commonwealth as part of the financing for this project. The tables on page 11 shows the payments received for the past five fiscal years and future anticipated payments. These funds are in addition to funds from the Commonwealth and federal funds for the project.

Finally, the Capital Projects Funds will continue to show a deficit with respect to the Highway Capital Projects Fund for the foreseeable future. That fund's deficit will be amortized through FY20 to pay for the MBTA forward funding.

**Capital Projects Funds –**  
**Fund Balance (Deficit)**  
**(Amounts in Thousands)**



The graph Capital Projects Funds – Fund Balance (Deficit) shows the combined fund balance in Capital Projects Funds for the past five years. The Capital Projects Funds – Operations table includes the FY00 Capital Projects Funds, summarized and compared to FY99. Financial statements for each of the individual funds are included in the financial section of this report.

**Capital Projects Funds - Operations**  
(Amounts in thousands)

	1999	2000
Beginning fund balance (deficit).....	\$ (349,036)	\$ 166,813
Revenues and other sources:		
Federal grants and reimbursements.....	6,354	2,529
Departmental and miscellaneous.....	11,805	10,709
Payment from Authorities.....	1,082,234	152,928
General obligation financing.....	1,014,806	1,761,621
Proceeds of refunding bonds.....	498,792	-
Transfers from budgetary surplus.....	110,414	-
Transfer for Capital Projects Funds.....	985,030	128,977
Transfer for Federal Reimbursements.....	577,975	484,187
Transfer from Transitional Escrow.....	-	16,800
Transfers and other sources.....	685,182	1,353,299
Total revenues and other sources.....	4,972,592	3,911,050
Expenditures and other uses:		
Acquisition of assets.....	2,848,330	2,918,181
Payments to refunded bond escrow.....	498,792	-
Transfer for debt defeasance.....	-	150,000
MBTA Forward Funding Transfer.....	-	612,750
Transfers and other uses.....	1,109,621	882,490
Total expenditures and other uses.....	4,456,743	4,563,421
Excess (deficiency) of revenues and other sources over expenditures and uses.....	515,849	(652,371)
Ending fund balance (deficit).....	\$ 166,813	\$ (485,558)

The Commonwealth has a practice of pooling cash from all governmental funds, so the short-term cash deficits in the Capital Projects Funds create a drain on the Commonwealth's overall cash flow. The five-year graph on page 9 shows the effect of elapsed time between capital expenditures and the sale of related debt. The Commonwealth could have issued additional authorized bonds in the amount of \$97.1 million. Had such action been taken, individual fund deficits would have been reduced and cash balances would have increased by that amount.

The Administration has implemented a coordinated fiscal strategy for the management of Capital Projects Funds. This strategy includes a five-year capital budget linked to debt management and cash management. The focus of this strategy is to manage capital spending and outstanding debt to levels the Administration considers appropriate for the Commonwealth. An important part of the strategy is to control capital spending within an annual administrative "cap." As additional capital outlays have been enacted and significant projects such as the Central Artery / Tunnel Project have been authorized, it becomes more challenging to restrain spending to such limits. Strategies to manage this situation, such as alternative financing for capital projects, are needed. The MTA and Massport's participation in the Central Artery / Tunnel Project and the judicious use of operating surpluses should continue.

***Estimated and Actual Payments  
From the Authorities  
(Amounts in Thousands)***

<u>Fiscal Year</u>	<u>MTA</u>	<u>MassPort</u>
<u>Actual</u>		
1996	\$ 100,000	\$ -
1997	-	-
1998	100,000	12,100
1999	1,051,000	31,000
2000	100,000	52,438
Total	<u>\$ 1,351,000</u>	<u>\$ 95,538</u>
<u>Estimated</u>		
2001	204,000	65,000
2002	-	-
2003	-	105,000
2004	-	50,000
2005	-	50,000
Total	<u>\$ 204,000</u>	<u>\$ 270,000</u>
Total *	<u><u>\$ 1,555,000</u></u>	<u><u>\$ 365,538</u></u>

\*The MTA estimates it will contribute an additional \$238 million, including estimated proceeds from sales of assets and garage and surface restoration work connected to the project.

The reductions in debt service from budgeted fund balance transfers for defeasance will be used, in part, to fund an initiative from FY01 through FY05 to rehabilitate the Commonwealth's road and bridge infrastructure. According to Massachusetts Highway Department statistics, during the last seven years, road and bridge construction projects statewide totaled over \$4.2 billion in spending, exclusive of the Central Artery / Tunnel Project. Road and bridge construction statewide has averaged \$609.5 million in spending per year from FY94 to FY00 compared to an average of \$395 million in spending per year from FY89 to FY93. The financing plan increases this average, exclusive of the Central Artery / Tunnel Project for the next five years.

The Commonwealth also completed during August 2000, the financing of lease revenue bonds in connection with the Route 3 North Project, a long – neglected, narrow and congested highway from the New Hampshire border to Route 128 / 95 in Burlington. This financing is the first of its kind in the Commonwealth. A nonprofit corporation has been created to accept lease payments from the Commonwealth and award a singular contract to a development team to design, build, and potentially maintain the highway. When the project is completed in late FY04, estimated travel times are expected to be reduced in a 12-mile stretch of the road from 40 minutes to 15 minutes.

A similar type of financing was used to fund the infrastructure improvements committed to by the Commonwealth for the new stadium housing the New England Patriots football team in Foxborough. A separate industrial development board was set up in the Town of Foxborough to bond for these improvements, with contract assistance payments from the Commonwealth as a source of payment on the bonds. The board will pay the construction contractor \$70 million for the improvement commitment from the Commonwealth out of the proceeds of these bonds.

***Fiduciary Funds (Excluding Agency Funds)***

The Fiduciary Funds record the Commonwealth's responsibility for assets it controls on behalf of other parties. Examples of such funds are the Unemployment Compensation and Pension Trust Funds. The table on the following page, which excludes assets held on a purely custodial capacity in so-called Agency Funds, summarizes the FY00 activity of the Fiduciary Funds. Over 92% of this Fiduciary Fund activity is related to the Commonwealth's Pension Fund detailed in fund statements found in this report.

On September 7, 2000, the Commonwealth updated its pension valuation. The valuation was based on data as of January 1, 2000. Details of this valuation are outlined in note 11.

**Fiduciary Fund - Operations**  
(Amounts in thousands)

	1999	2000
Beginning fund balance.....	\$ 25,123,216	\$ 28,387,447
Revenues and other sources:		
Taxes.....	883,503	861,843
Federal reimbursements.....	29,335	31,481
Departmental and other revenues.....	1,776,578	1,551,987
Interfund transfers and other sources.....	9,295	21,587
Investment earnings.....	2,904,495	4,480,252
Total revenues and sources.....	5,603,206	6,947,150
Expenditures and other uses:		
Expenditures.....	2,268,725	2,407,771
Interfund transfers.....	70,250	66,048
Total expenditures and uses.....	2,338,975	2,473,819
Excess of revenues and sources over expenditures and uses.....	3,264,231	4,473,331
Ending fund balance.....	\$ 28,387,447	\$ 32,860,778

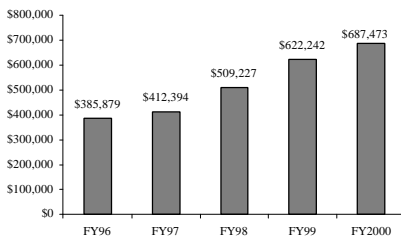
***Non-Appropriated Funds of Higher Education***

The SBFR includes the financial operations of the non-appropriated funds of the 25 Institutions of Higher Education in the statistical section of this report. Over the past few years, significant efforts have been taken by our office and the institutions to improve the accuracy and timeliness of this Higher Education segment of the financial report. Each Institution of Higher Education is authorized and directed in its enabling statute to collect, retain and expend certain fees, rents, sales, donations, federal financial participation and other types of revenue through campus based systems. These financial resources are integral parts of the total financial activity of each campus. They also represent resources in addition to amounts made available from Commonwealth appropriations.

**Non-Appropriated Funds Of Higher Education - Operations**  
(Amounts in thousands)

	1999	2000
Beginning fund balance.....	\$ 509,227	\$ 622,242
Revenues and other sources:		
Federal Grants and reimbursements.....	200,149	208,573
Departmental and miscellaneous.....	866,700	1,067,601
Transfers and other sources.....	383,842	100,476
Total revenues and other sources.....	1,450,691	1,376,650
Expenditures and other uses:		
Programs and services.....	973,214	1,202,380
Transfers and other uses.....	364,462	109,039
Total expenditures and uses.....	1,337,676	1,311,419
Excess (deficiency) of revenues and other sources over expenditures and other uses.....	113,015	65,231
Ending fund balance.....	\$ 622,242	\$ 687,473

***Non-Appropriated Funds of Higher Education – Fund Balance  
(Amounts in Thousands)***



The Non-Appropriated Funds for Higher Education – Operations table includes the FY00 funds, summarized and compared to FY99. Financial statements for each of the individual funds are included in the statistical section of this report. The graph Non-Appropriated Funds for Higher Education – Fund Balance shows the combined fund balance for the past five years. The combined balance represents \$554.6 million for the University of Massachusetts, \$69.0 million for the State College system and \$63.9 million for the Community Colleges. These balances are designated for specific purposes, such as restrictions on endowments or other specialized purposes specified by the funding contributions.

## ***Conclusions And Recommendations***

The Commonwealth has many accomplishments in FY00 of which it can be proud. I would like to highlight three here.

February of this year was the culmination of a multi-year effort to rethink the Commonwealth's human resource and payroll practices and replace multiple legacy systems with one statewide Human Resource Compensation Management System (HRCMS). In a Commonwealth-wide effort, the personnel and payroll practices of the Commonwealth were dissected and reconstructed for the 21<sup>st</sup> century. Departments across state government were led by an Executive Committee, chaired by the Personnel Administrator, James Hartnett. The committee had representatives from the Judiciary, Board of Higher Education, Group Insurance Commission, Information Technology Division, Fiscal Affairs Division and the Office of the Comptroller. Examples of the business process changes include the elimination of paper. Prior to HRCMS, 68% of employees received their pay through direct deposit. Today, over 93% do, reducing banking costs across the Commonwealth. All payroll deductions have also moved to electronic processes. Checks and paper reports have been replaced with electronic payments and data files for all payroll deductions, such as purchases of transit passes, insurance, annuities and payments among the Commonwealth departments. This Project eliminated the control risks and inefficiencies associated with the payment of \$250 million annually. A dedicated team of state employees and contractors worked countless nights and weekends making this, the first major financial system replacement since 1986, an outstanding success. With the implementation of HRCMS, systems are more flexible and efficient. Information has become readily accessible to decision makers in the Commonwealth.

The long-feared Y2K crisis never arrived in the Commonwealth. This was not because the risk did not exist. The dedicated effort of thousands of employees across the Commonwealth identified systems and software that were non-compliant and implemented solutions to insure uninterrupted service as we entered the new millennium. Under the leadership of the Chief Information Officer, David Lewis, the Commonwealth in many instances did more than solve the problem. We used Y2K as an opportunity to review business practices and the technology supporting those business practices. As a result, instead of carrying 1990's technology forward into the next century, new systems taking advantage of new technologies have been put in place.

In 1998, the Office of the Comptroller, in conjunction with the Information Technology Division and the Operational Services Division, embarked on a pilot initiative known as the electronic mall or “eMALL.” This past summer after conclusion and evaluation of the pilot, the first “production state” e-Procurement system was launched. eMALL is part of the online government effort by the Commonwealth. The eMALL is an extranet application where Commonwealth agencies can prepare their orders for commodities, interact with the Commonwealth’s back-end financial systems, place the approved orders with their suppliers, mark goods as received and create automated payments through the accounting system, all done over the internet. The eMALL will expand to other Commonwealth entities such as cities and towns, public authorities and also to other states in order to maximize purchasing power and realize economies of scale. The e-Government effort will expand the existing scope of state on line services to create a fully integrated enterprise portal for the Commonwealth.

Building upon the observations in this letter, a detailed review of these financial statements suggests the need for action to further improve and strengthen state finance law and fiscal practice.

**The Commonwealth must constantly monitor and update its systems and controls.** Upon taking office 18 months ago, I began a multi-year effort to expand awareness of and the quality of internal controls throughout the Commonwealth. We have asked each department, at its highest levels, to assess its risks and target controls to manage those risks efficiently and effectively. Toward this end the Office of the Comptroller has continued a multi-pronged effort to improve controls throughout the Commonwealth. This effort must continue.

**The Commonwealth must ensure that its bills are paid on time.** A solid reputation of timely bill payments benefits both our business partners and the taxpayers. During FY00, this office began a campaign with the Chief Fiscal Officers in the 156 state departments to improve the percentage of bills paid within 30 days. The timing and focus on bill paying improved the Commonwealth’s bill payment track record this year to 82% of all bills paid within 30 days. This effort will continue until we have reached and maintained a 95% level.

**The Commonwealth should adopt a more straightforward definition of fiscal balance including all of the budgeted funds.** The idiosyncratic definition of fiscal balance that includes a portion of fund balance within three of the 63 budgeted funds should be expanded to include all 63 funds.

**The Commonwealth should reduce the number of funds and eliminate funds that have chronic deficits.** The Commonwealth currently maintains over 122 individual funds to record its financial activity. This excessive number of funds fragments the Commonwealth’s financial picture. Many of these funds have structural imbalances leading to chronic deficits. Two small steps were taken in FY00. Legislation was enacted authorizing the Comptroller to transfer among the 3 major budgeted funds, eliminating the most egregious

***Funds with Significant Deficits  
(Amounts in Thousands)***

	<u>1999</u>	<u>2000</u>
Harbors and Inland Waters		
Maintenance.....	\$ (2,121)	\$ (4,537)
Toxic Use Reduction.....	(4,608)	(5,949)
Environmental Permitting & Compliance Assurance.....	(26,947)	(34,474)
Environmental Law		
Enforcement.....	(1,872)	(2,914)
Environmental Challenge.....	(4,176)	(5,087)
Marine Fisheries.....	(3,814)	(4,359)
Second Century.....	(4,124)	(4,843)
Victim and Assistance.....	(5,653)	(7,484)
Intercity Bus Capital		
Assistance.....	(7,084)	(6,470)
Government Land Bank.....	(35,097)	(35,097)

deficits. In addition my office reviewed funds established administratively and eliminated six Capital Projects Funds where the level of activity has become immaterial enough to be consolidated into other funds. The effort to reduce the number of funds should continue. The table, Funds with Significant Deficits, identifies funds with significant deficits that remained unfunded or continued to grow during FY00 or where no plan exists to bring them into balance. The structure of these funds should be changed to balance revenues with expenses or the funds should be eliminated and their activity consolidated into the General Fund.

**The management of the spending to the administratively capped debt limit should continue.** The Commonwealth has committed to an extensive capital projects agenda and great discipline will be needed to assure spending on these projects is matched with financing from bonds, federal reimbursement, transfer of budgetary surplus and financial participation from component units. Assuring proper balance between outflows and inflows, and limiting the segment funded by bonds to the administratively imposed limit, will be a major challenge.

**The Commonwealth should continue to emphasize optimization of both tax and non-tax revenues.** This statewide campaign has generated nearly \$202 million in revenues since FY96. The revenue optimization strategy should continue.

**The Commonwealth must continue its investment in information technology as a means of delivering services as expeditiously and transparently as possible.** This fall, Governor Cellucci launched a statewide initiative, under the direction of Secretary Crosby, to reconceptualize the way government interacts with its customers. As part of the initiative, we will serve our citizens quickly, fairly and as accurately as possible on their schedules. We will eliminate “stand-alone” systems to streamline information. We will make it as easy as possible for citizens to interface with us. In our increasingly busy and stressful world, it is critical that government continue to “re-invent” itself.

I again would like to express my thanks to the many dedicated people within the Office of the State Comptroller. We have had another successful year within the office. Our office has undertaken many tasks this year: a successful Y2K transition, a successful implementation of the HRCMS system, and a dedicated effort helping to implement forward funding of the MBTA. As we go forth into FY01, we are embarking on the redesign of our separate Comprehensive Annual Financial Report due to Government Accounting Standards Board Statements 34 and 35. We are also investigating a potential upgrade to MMARS. I am proud to have all the 115 employees of the Comptroller’s Office on my team to help tackle these and other difficult issues of the future.

Respectfully submitted,

Martin J. Benison  
Comptroller

